

Shipper Perspective

With Tom Craig and Gary Ferrulli

Upcoming tsunami – Part 3: shippers

This is the third, and final, part of our discussion of the pending maritime financial tsunami. Shippers are, for this discussion, the direct buyers of ocean transport.

They use service contracts, spot market rates, relationships with carriers, and other methods to get rates for their shipments.

There are two buyer subsets—BCOs and OTIs. They are different and have different agendas. BCOs are beneficial cargo owners, while OTIs are the ocean transport intermediaries which include freight forwarders, third party logistics providers, and other similar service providers.

BCOs are supposed to buy services that align with their supply chains. They should segment their supply chains and utilize the carriers whose services best match each segment.

Service, however, does not seem to be a primary goal for many BCOs:

- Based on Drewry's research, carrier on-time service and reliability in the major trade lanes are not good. That opens up the question as to what shippers are buying.

- Supply chain executives are under pressure not to take price increases. As a result, they utilize poor service carriers, which, in turn, increases the amount of inventory each company must carry to buffer for the poor reliability. Interestingly, many supply chain executives are faced with contradictory directives to not take price increases and avoid increasing inventories.

- With carrier alliances, a firm can contract with a good service carrier, but then be forced to use those carriers with lackluster service that are also apart of the alliance.

Smaller intermediaries are rate shoppers. Service is often a secondary issue to them, but having space from multiple service providers has proven to be a valuable option for their customers. There are large OTIs who play both sides, lower rates and guaranteed space, but it's a fragmented industry with many participants.

What will these two buyer groups do when—

- The tsunami hits and as many as five container lines go out of business?

- When there's less reason for carriers to keep rates low due to excess capacity?

- With alliances broken due to lines disappearing and not all ports capable of handling mega-ships, there could be different ports for exports and imports, which impacts supply chain costs and performance?

Shippers have essentially stood by while this tsunami has formed. They enjoyed the low rates that were part of the tsunami's formation. They played no statesman's role to bring resolution and mitigate what's happening. They took the short-term benefits vs. the potential long-term negative impact.

So what do BCOs and OTIs do when a major carrier (or carriers) closes down operations, or even just exits a trade? On the assumption that the carrier going out of business was chosen because of the lowest rates, then the shipper goes to the next lowest rate-providing carrier or shops for rates. If other reasons, then look for another carrier in the same alliance using virtually the same service.

But what if over time, a group of carriers leave? Gone are the days when someone can cheaply charter enough ships to give them a service, lease containers, get agents, and be in business.

So now shippers will wind up with fewer carriers, with potentially less capacity. The capacity situation isn't likely to be a problem for long, as the remaining carriers will adjust fleet sizes to the markets. There will simply be fewer carriers. Will there be fewer alliances with fewer carriers? Possibly. But carriers currently see the benefits of alliances.

What happens to rates? Rates in ocean transportation are very much a reflection of the markets and there is no reason to assume that this will change. Supply/demand ratios will win the day. In tight trades, rates will move higher; in oversupplied trades they will fall. All this will have an impact on both shipper groups. BCOs will have fewer choices, and maybe not as fast or reliable

transit options, which creates supply chain operations problems and increases buffer inventories to compensate for the service uncertainties. OTIs and BCOs that are rate shoppers face a new market reality with higher rates. The happy days of cheap rates are over, and this will create a squeeze effect on their businesses—and put some in jeopardy. That will include BCOs who used low rates to mask their supply chain inefficiencies. The other question will be how many OTIs survive?

One last thought on this; in 1980 the Staggers Rail Act was enacted and, at the time, there were more than 15 Class I railroads in the United States. Competition was abundant. Over time, however, rail consolidation occurred and today there are just handful of viable Class I railroads; negotiations between shippers and these railroads have become more difficult; and shippers have had to find new ways to service certain locations because of abandonment and curtailing of service. Many large shippers who once supported deregulation are now calling for more regulation to be put upon the rail industry when it comes to rates and services.

Then superimpose today's rail situation to having, let's say, 10 container carriers which control 90 percent of the global fleet and carry 90 percent of the global trade. Might the shippers' world be different? Might their view of competition be different? You bet.

The pending maritime financial tsunami will start with the container lines and domino across the ports and shippers. There will be chaos. The greater the number of carriers that go under or are merged, the greater the upheaval. And, the end result will be a new paradigm of how shippers and ocean transport providers deal with each other.

Craig is president of consulting firm LTD Management and can be reached by email at tomc@ltdmgmt.com, and Ferrulli is president of Unicon Logistics, an NVOCC, and can be contacted by email at mrgtf4811@mindspring.com.



Craig



Ferrulli